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NABE Outlook

NABE MACROECONOMIC FORECAST RESULTS

May 1989

This report presents the consensus forecast results made by a select panel of 54 professional forecasters drawn from the membership of the National Association of Business Economists. The forecasts were made in early May following the release of the preliminary 1st quarter GNP data.

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Highlights from the May Survey

* *NABE's panel of forecasting experts is projecting continued economic growth for 1989, though the growth rate is expected to slow dramatically during the remainder of this year. The median forecast of the panel of 54 professional economists calls for 2.3 percent growth during the year on a 4th quarter-to-4th quarter basis. This projection compares with actual growth of 2.8 percent from the 4th quarter of 1987 to the 4th quarter of 1988. It is a couple of notches slower than the February forecast, and it implies an average growth rate of only 1.3 percent for the remaining three quarters of 1989.*

* *The panel took a first look at the economy in 1990 and expects a rise of 2.3 percent on a 4th quarter-to-4th quarter basis, the same as the 1989 projection.*

* *The panel sharply increased its inflation forecast for this year -- the median 4th quarter-to-4th quarter change in Consumer Prices is now 5.3 percent, a full percentage point higher than last year, and a half percentage point higher than the last forecast in February. The source of this inflation appears to be the twin shocks of energy and food prices which have already appeared in the system. The median forecast for 1990 CPI inflation is for 4.7 percent (again on a 4th quarter-to-4th quarter basis), a moderate slowdown from the 1989 pace.*

* *1990 continues to be the favored year for the arrival of the next recession -- 43 percent of our panelists chose that year (down from 56 percent in the last forecast). The proportion calling for a 1989 recession was 20 percent (the same as the last forecast), while a significant 37 percent thought that we could make it to 1991 or later without a business downturn.*

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* *Progress on the "twin deficits" is still expected to stall in 1989. While the median trade deficit forecast of $112 billion is a slight improvement over the $119.8 billion recorded in 1988, the budget deficit is expected to deteriorate to $160 billion in the current 1989 fiscal year, up from $155.1 billion last year, and well above the $138 billion Gramm-Rudman-Hollings (GRH) "deficit-reduction" ceiling. Both deficits are expected to improve slightly in 1990 -- the trade deficit to $100 billion and the budget deficit to $140 billion. While improved, the GRH process requires even faster progress, and the projected $140 billion budget deficit would be far above the $100 billion GRH ceiling for fiscal 1990. Note: The trade deficit is now being measured on the new Customs basis, which excludes insurance and shipping charges from imports.*

* *As was the case in last quarter's forecast, changes in actual market interest rates appear to be outstripping the panel's estimates. This time, however, the direction of change is downward. The panel's median forecast for June's three-month Treasury bill yield was 8.8 percent, unchanged from the March average. A gradual decline to 8.3 percent was expected by the end of this year. In the past three weeks, however, three-month T-bills were already trading at the expected year-end 8.3-8.4 percent range, and the yield curve had flattened perceptibly. The panel expects short-term interest rates to continue to decline throughout 1990, to a level of 7.3 percent by the end of that year.*

* *The same problem exists with the panel's long-term interest rate projections. The median panel forecast was for 30-year Treasury bond yields to average 9.1 percent in June, down only slightly from the 9.2 percent average in March. A flat profile at 9.0 percent was then expected for the remainder of the year, with a gradual decline beginning in 1990, which would bring the long rate down to 8.7 percent by the end of next year. Again, yields on 30-year bonds have already plunged to the 8.75 percent level.*

Is a "Growth Recession" Ahead?

The panel expects very slow growth -- only 1.3 percent at annual rates -- for the remainder of 1989. If correct, this would probably constitute a "growth recession, " a period of positive yet very slow growth for the economy. This below-trend growth would result in a moderate increase in the unemployment rate (to an expected 5.8 percent by the end of the year) and a small decline in capacity utilization. This might be enough to take the pressure off of inflation and allow the Federal Reserve to engineer the long-sought "soft landing," a transition from above-trend growth to a more stable, noninflationary rate near the long-term trend of the U.S. economy.

While a "soft landing" seems attainable, the real trick from an economic policy perspective is preventing the forces that are responsible for a major slowdown from degenerating into a full-blown recession. The early evidence that nonfood, nonenergy prices may be decelerating, when coupled with the ongoing declines in market interest rates, increase the chances for the soft landing to take place. It should be observed, however, that the U.S. has never escaped the onset of a recession in the mature phase of a cyclical expansion. Soft landings have often appeared possible -- such as in 1973-73 -- but inflation has invariably worsened. With the run-up in prices, government policy has been forced to squeeze still harder and soft landings are lost in the process.

Inflation Expected to Peak in 1989

Inflation, as measured by the Consumer Price Index for All Urban Consumers, is expected to peak in 1989, as the oil and food price shocks ripple through the system. The CPI is expected to rise by 5.3 percent on a 4th quarter-to-4th quarter basis, somewhat faster than the panel's estimates of the rise in the GNP deflator. To achieve the 5.3 percent rise in the CPI this year,

however, the CPI will need to slow markedly during the second half of 1989. During the 1st quarter, the annualized inflation rate was 6.1 percent, and April's 0.7 percent rise (8.4 percent at annual rates) will probably cause the 2nd quarter's pace to equal or exceed that of the 1st quarter. Inflation in 1990 is anticipated to retreat to 4.7 percent.

Convergence in the Forecast

As the year proceeds, the difference (in terms of real GNP growth for 1989) between the optimistic and pessimistic panel members continues to close, as can be seen from the table below:

Real GNP Growth (4Q88-4Q89)	Estimates of Survey in: Aug 88	Nov 88	Feb 89	May 89
Median Forecast	2.0%	2.2%	2.5%	2.3%
Upper Quartile (25%)	3.0	3.2	3.4	3.0
Lower Quartile (25%)	0.6	1.1	1.4	1.5
Spread (Upper - Lower)	2.4	2.1	2.0	1.5

The most pessimistic members have increased their forecasts almost a full percentage point since the August 1988 forecast -- possibly a reflection of the postponement of the arrival of the next recession. On the other hand, the optimists' forecasts are relatively unchanged.

Sector Outlook -- Less Ebullient

Although the panelists are looking for real GNP growth at a 2.8 percent year-over-year rate in 1989, essentially unchanged from the 2.7 percent in February, they have lowered their forecasts for several major sectors:

* *Industrial production is now expected to grow at 3.2 percent, as opposed to 3.4 percent in February. The median forecast is for a slowdown to 1.8 percent (on a year-over-year basis) for 1990. Again, caution must be taken in interpreting these year-over-year forecasts. As explained in the highlights section, most of the economic slowdown in the median forecast seems to be taking place in the last half of 1989 and does not show up in the year-over-year figures until 1990.*

* *Housing starts are now forecast to average 1.41 million units, down slightly from the 1.44 million in the last forecast. The expectation of lower interest rates in 1990 leads to a slight improvement in that year's starts, to a 1.44 million level.*

* *The median forecast for auto sales is 9.9 million units, down from the February figure of 10.2 million and down dramatically from the 10.6 million units in 1988. The decline is expected to be shared by both domestic and imported cars. In addition, van and truck sales are expected to be 5.0 million, also down from the 1988 levels. Sales in 1990 are expected to be flat at this year's levels.*

Quarterly Interest Rate Forecasts

Our panel provide us with a quarterly path for both short and long-term interest rates. The forecasts for the average interest rates for the last month in each quarter, along with the average of the upper and lower 25 percent, are shown on the next page:

Table 1

Quarterly Interest Rate Projections

	Actual	Projections						
	Mar89	Jun89	Sep89	Dec89	Mar90	Jun90	Sep90	Dec90
3 Month Treasury Bills								
- median	8.8%	8.8%	8.5%	8.3%	8.0%	7.8%	7.5%	7.3%
- upper 25%		9.1	9.3	9.3	9.2	8.9	8.7	8.7
- lower 25%		8.3	7.9	7.2	6.9	6.6	6.4	6.1
30-Yr. Treasury Bonds								
- median	9.2%	9.1%	9.0%	9.0%	8.9%	8.8%	8.7%	8.7%
- upper 25%		9.4	9.7	9.8	9.8	9.7	9.6	9.6
- lower 25%		8.9	8.7	8.4	8.2	8.1	7.9	7.7

The Prospect of a 1989-1990 Recession Continues to Recede

Although a majority of our panelists still expects a recession before the end of 1990, the percentage has dropped to 63 percent, down from 75 percent in the February forecast and 89 percent in November. More significantly, 20 percent of respondents do not expect a downturn before 1992.

Table 2

Timing of the Next Recession

Next Recession Begins In:	Percent of Respondents in				
	May 88	Aug 88	Nov 88	Feb 89	May 89
1989	57.4%	47.3%	40.0%	19.2%	19.6%
1990	31.5	41.8	48.3	55.8	43.5
1991	1.9	9.1	8.3	17.3	17.4
1992 or later	3.8	1.8	3.3	7.7	19.6

Table 3
Summary of NABE Median Forecasts

	1988 Actual	1989 Forecasts: Aug 88 Survey	Nov 89 Survey	Feb 89 Survey	May 89 Survey	1990 F'cst May 89 Survey
Fourth Quarter to Fourth Quarter						
Real GNP	2.8%	2.0%	2.2%	2.5%	2.3%	2.3%
Consumer Price Index	4.3%	5.1%	5.0%	4.8%	5.3%	4.7%
Annual Averages						
Real GNP	3.9%	2.3%	2.5%	2.7%	2.8%	1.8%
Pers. consum. expend.	2.8%	2.0%	2.0%	2.5%	2.5%	1.9%
Nonres. fixed invest.	9.5%	3.7%	4.3%	4.0%	4.6%	1.8%
Net exports (BB 82$)	-$99.1	-$67	-$76	-$85	-$90	-$76
Nominal Magnitudes:						
Merch. trade bal.	-$119.8	-$103#	-$103#	-$103#	-$112	-$100
Fed. budg. def.(FY)	-$155.1	-$150	-$150	-$155	-$160	-$140
Corp. prof.(aft.-tax)	14.6%	5.0%	5.2%	6.3%	5.3%	1.9%
Real Magnitudes:						
Unempl. rate (civ.)	5.5%	5.6%	5.6%	5.5%	5.4%	5.8%
Indus. production	5.7%	2.9%	3.0%	3.4%	3.2%	1.8%
Housing starts (MM)	1.49	1.41	1.40	1.44	1.41	1.44
Total Veh. Sales (MM)	15.9	N.A.	N.A.	N.A.	14.9	14.9
Pass. Cars (MM)	10.6	10.0	10.0	10.2	9.9	9.9
Vans & Trucks	5.3	N.A.	N.A.	N.A.	5.0	5.0
Inflation and Interest Rates:						
Consumer price index	4.1%	5.0%	5.0%	4.7%	5.1%	4.8%
GNP deflator	3.4%	4.4%	4.4%	4.5%	4.6%	4.4%
Treasury bills (3 mo.)	6.7%	7.4%	7.5%	8.0%	8.6%	7.6%
Treas. bonds (30 yr.)	9.0%	9.6%	9.5%	9.2%	9.1%	8.8%

Old forecast adjusted for new Customs definition.

The May 1989 columns are based on 54 responses received.

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When Will the Next Recession Start?